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JAPAN'S SOCIAL SECURITY AND PENSION SYSTEMS FACE NEED FOR NEW REFORMS

Summary

Like most advanced industrialized nations, Japan has set up a state-run social security system that serves a variety of income-providing and income-leveling functions. But unlike others among its peers, Japan is faced much more quickly with making the leap from a not-so-aged society to one with a tight retiree/worker ratio. Although reforms implemented in 1986 are helping to adjust the benefit system and the related impact on the national budget, further actions have bogged down. Plans to delay the age of retirement and the age at which benefits become available may be in political limbo.

Yet policymakers do not have the luxury of time. The first wave of Japan's baby-boom generation will face retirement in just 15 years or so. Accommodating this hefty chunk of society in retirement could cause more than a ripple effect on the economy. This first generation to benefit from Japan's economic juggernaut has the potential in retirement to disrupt savings rates as well as Japan's fairly equal income distribution.

Between the Rock of Age and a Hard Place

Pension experts, bureaucrats and politicians began voicing concern in the mid-1980s about how Japan was to cope with a rapidly aging society, one in which the group of people aged 65 and over is increasing at a faster rate than the pool of workers aged 15 to 64 (see Tables 1-3). The world's longest life expectancy (81.3 years for women and 75.5 years for men) and a shrinking birth

Table 1: Comparison of Demographic Transition

(percent of population aged 65 or older)

Country	7 Percent	14 Percent	Doubling Time
Japan	1970	1996	26 years
West Germany	1930	1975	45 years
Great Britain	1930	1975	45 years
Italy	1935	1990	55 years
United States	1945	2015	70 years
Australia	1940	2020	80 years
Sweden	1890	1975	85 years
France	1865	1995	130 years

Source: Ministry of Health and Welfare

Table 2: Selected Countries' Dependency Ratio

(population aged 65 and over to working ages 15-64)

Country	1980	1990	2000	2010	2020	2030	2040	2050
Japan	13.4%	16.6%	22.4%	27.5%	33.7%	31.8%	37.5%	37.6%
United States	17.1	18.7	18.3	18.5	25.0	31.7	32.4	31.8
West Germany*	23.4	22.5	25.1	30.3	33.2	43.4	48.8	42.3
France	21.9	21.0	23.1	24.0	30.5	35.9	38.7	37.8
United Kingdom	23.3	23.1	22.3	22.1	25.6	31.3	33.1	30.4
Italy	20.8	20.3	22.9	25.6	28.7	35.3	42.1	37.8
Canada	14.1	16.8	19.0	21.3	29.0	37.2	37.8	36.4

*Excludes impact of proposed unification with East Germany.

Source: Organization for Economic Cooperation and Development, Working Papers: Ageing Populations: Economic Effects and Implications for Public Finance (Paris: 1988), p. 37.

rate (1.66 births per female of child-bearing years in 1988 versus 2 in 1961) are moving Japan toward a potential situation in the early 21st century of having only three workers to support every senior citizen instead of the current six-to-one ratio. Although educational and social welfare costs associated with the young will drop accordingly, the offsets are not expected to be sufficient to balance the increased outlays for seniors' social security, defined in Japan as encompassing a basic benefit, medical insurance and welfare costs.

Both Japan and the United States follow a trust-fund approach to social security, in which contributions made today are supposed to benefit at retirement those who paid them. In reality, the premiums pay current benefits and buy

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Table 3: Japanese Labor Force by Age, 1981-88*

(in millions)

	15-24			25-39			40-54			55-59**			60-64			65 and Up		
Year	Labor Force	Number Working	Outside Force	Labor Force	Number Working	Outside Force	Labor Force	Number Working	Outside Force	Labor Force	Number Working	Outside Force	Labor Force	Number Working	Outside Force	Labor Force	Number Working	Outside Force
1981	7.00	6.72	9.02	21.46	21.01	7.07	19.18	18.91	4.79	9.44	9.17	11.93	--	--	--	--	--	--
1982	7.02	6.71	9.13	21.32	20.86	6.83	19.64	19.33	4.75	9.75	9.47	12.39	--	--	--	--	--	--
1983	7.29	6.96	9.17	21.26	20.73	6.55	20.13	19.75	4.63	10.21	9.89	12.72	--	--	--	--	--	--
1984	7.34	6.98	9.37	21.02	20.49	6.41	20.48	20.10	4.62	4.75	4.59	2.01	2.74	2.61	2.37	2.95	2.90	8.94
1985	7.33	6.98	9.70	20.98	20.46	6.37	20.56	20.20	4.60	4.88	4.73	2.05	2.88	2.74	2.47	3.00	2.95	9.31
1986	7.54	7.16	9.88	21.14	20.61	6.32	20.46	20.10	4.53	4.98	4.81	2.13	3.05	2.90	2.60	3.02	2.98	9.68
1987	7.65	7.24	10.21	20.85	20.31	6.06	20.85	20.44	4.61	5.14	4.96	2.13	3.22	3.05	2.73	3.12	3.09	10.10
1988	7.82	7.44	10.47	20.30	19.82	5.81	21.62	21.26	4.61	5.28	5.13	2.16	3.37	3.21	2.87	3.26	3.22	10.43

*The labor force is characterized as all employees eligible or wanting to work. The number working includes self-employed workers who have not been absent from work for more than 30 days.

**Includes all those over the age of 55. Further detail from 1984 on was made available on older workers in the 1988 Yearbook of Labor Statistics.

Source: Ministry of Labor, Yearbook of Labor Statistics, 1985 and 1988.

government securities that, when they come due in the future, will cover payments for that generation of senior citizens. Now being debated in the United States is whether the premiums set by the 1983 revisions to the Social Security Act are creating an unnecessarily heavy burden on current workers by generating more money than is needed to pay present benefits and, in the process, encouraging the government to use the surplus to fund other programs as well as fueling high government debt that will have to be redeemed by future generations.

In Japan social security payments as well as premiums paid into the government-run pension program generally enter trust fund accounts used to build infrastructure and various other projects under the Fiscal Investment and Loan Program. The debate there is whether a better return could be achieved bypassing the Ministry of Finance's trust fund, which pays 5.1 percent, and investing more of the contributions in private-sector investments that offer a current return of about 9.1 percent.

Fears about the drain on the general account budget, which covers roughly a third of basic benefits (see Tables 4-5), are leading to questions like:

Table 4: Public Pension Expenditures in Japan and the United States and Share of GDP, 1975-85

(in billions of yen* and millions of dollars)

Country	1975	1977	1979	1981	1983	1985
Japan**						
Expenditures	Y3.89	Y6.59	Y8.98	Y12.05	Y14.39	Y16.89
Share of GDP	2.6%	3.6%	4.1%	4.7%	5.1%	5.3%
United States***						
Expenditures	$105.97	$131.88	$162.56	$215.64	$255.30	$285.20
Share of GDP	6.7%	6.7%	6.6%	7.2%	7.6%	7.2%

*The yen figures can be converted into dollars at the following average annual exchange rates: 1975, Y305.15; 1977, Y240.00; 1979, Y239.70; 1981, Y220.54; 1983, Y237.51; and 1985, Y238.54.

**Includes national pensions, seamen's insurance and mutual benefit association pensions, pension funds, welfare pensions, civil service pensions as well as compensation for civil service casualties and other casualties, including the nonmedical aspects of workmen's compensation, except for that associated with suspension from work.

***Includes old age, survivor's and disability insurance (also known as social security), federal civilian and military pensions, railroad retirement, veterans' pensions, disability and life insurance benefits, state and local pensions and supplemental security income as well as benefits for black lung disease.

Source: Organization for Economic Cooperation and Development, Annual National Accounts (Paris: various years), and Social Data File, Reforming Public Pensions (Paris: 1988), pp. 140-141.

Table 5: Social Security* Outlays in Japan and Contributions, 1979-87

(in billions of yen**)

Year	Outlays	Contributions	Percent
1979	Y21,801	Y16,049	73.6%
1980	24,169	17,513	72.4
1981	27,164	20,072	73.9
1982	29,665	21,646	73.0
1983	31,647	22,896	72.3
1984	32,945	24,270	73.7
1985	34,918	26,185	75.0
1986	37,551	27,767	73.9
1987	40,331	29,765	73.8

*Includes all types of public pensions, health insurance and other welfare payments.

**The yen figures can be converted into dollars at the following average annual exchange rates: 1979, Y239.70; 1980, Y226.74; 1981, Y220.54; 1982, Y249.08; 1983, Y237.51; 1984, Y237.52; 1985, Y238.54; 1986, Y168.52; and 1987, Y144.64.

Source: Economic Planning Agency, Annual Report on National Accounts.

what degree of income support should senior citizens receive and at what age should the older worker be encouraged to retire. Even more complex are such issues as whether unfolding demographic and societal changes will upset components of Japan's economic miracle, such as the country's high savings rate, and an employment system based on seniority.

Adjustments to a Maturing System

Reforms to the government-operated social security and retirement system went into effect in April 1986. The Organization for Economic Cooperation and Development said that among its member countries "the Japanese reform probably constitutes the most radical reform of public retirement provisions to have been attempted in the last decade."[1] By the mid-1980s Japan's immature state-run program was paying out substantially more to those who were retiring than they had contributed. (Pension expert Kiyoshi Murakami blames this partially on many elections' worth of campaign promises that ignored the need to adjust contribution rates.) The increases presented little problem in a booming economy where contributors substantially outweighed recipients. However, after a good look at the baby-boom bulge making its way through the system, policymakers engineered changes. These addressed not only a reduction in benefits per contributions but the plight of women who had not entered the work force and might not be counted as eligible for a spouse's benefits (through divorce, for example).

[1]Organization for Economic Cooperation and Development, Reforming Public Pensions (Paris: 1988), p. 112.

Basic Benefits - The nonmedical portion of the social security system, which previously left many elderly with no other income support than their own resources, covers all residents, usually at age 65. Moreover, all residents between the ages of 20 and 60 must participate (although exclusions are allowed under some circumstances). Whether a person is self-employed, works for a company, belongs to a mutual-aid association, such as those covering railroad workers, or even is outside the work force, he or she now pays into the national pension scheme (kokumin nenkin) and is eligible to receive a basic benefit.[2]

Unlike the American system, which requires the self-employed to pay premiums equal to the percentage paid by both employer and employee (15.3 percent of applicable earnings in 1990), the independent worker in Japan pays the same flat portion that others do, currently about Y8,300 a month ($55.33 at Y150=$1.00). A working spouse covers his or her partner's contribution; an employed parent might contribute for a 20-year-old child who is not working. Those unable to pay premiums still are eligible for benefits as a result of the pooled resources to which the government adds one-third. In December 1989 the Diet increased premiums about 2 percent and benefits about 6 percent. Monthly benefits, always paid out in the form of an annuity, currently amount to Y55,500 ($370) for a person who has contributed for 40 years (proportionately less for fewer years of participation).

Employees' Pension Insurance - Covered by a second tier of benefits are employees earning wages or salaries. An estimated 28 million of the 60 million workers in Japan fit this category and participate in the government-run employees' pension insurance scheme (kosei nenkin). While participation is mandatory for incorporated firms, the program is optional in several industries, usually those that are service-related. On top of paying the flat-rate premium for the social security benefit (and covering any nonworking family members), an employee matches contributions with his or her employer at a current rate of about 6.2 percent of monthly remuneration, which excludes bonuses. (The rate for women currently is 6.05 percent, but by 1993 the two rates are to converge.) The employee's contribution to the EPI fund is not taxed until benefits are paid out; employers can deduct premiums as a business expense.

As a carryover from the days when 55 was the accepted retirement age -- which it still is for many firms -- a 60-year-old retiree can start to receive EPI benefits. (Under the 1986 reforms 55-year-old women could begin getting payments, but by the year 2000 the eligible age for both sexes is expected to be uniform.) A current major debate is whether Tokyo will be able to boost the eligible age for pension benefits to 65. Labor unions are among those opposed

[2]Just like the old age, disability and survivor's insurance provided under America's social security system, Japan's basic benefits include not only an old-age benefit but disability payments available to qualifying persons aged 20 and up and a survivor's pension. Even though Japan's constitution recognizes equality of the sexes, the survivors' pension is specified for a widowed mother or bereaved children. For the survivors and those not totally disabled the monthly payment in 1988 was Y52,208 ($348 at Y150=$1.00), although the surviving widow could receive Y15,658 ($104) each for up to two children and Y5,225 ($35) for each additional child.

to the delayed payout, particularly since the average retirement age is currently 62 (see JEI Reports No. 44B, November 17, 1989, and No. 11B, March 16, 1990).

Instead of channeling EPI contributions into the government's pension fund, which is run by the Ministry of Health and Welfare, large corporations can make tax-deductible contributions to a privately run, nonprofit company set up solely to manage the EPI monies. These firms are called kumiai. Participating companies, instead of contributing the EPI rate of 6.2 percent of a worker's basic salary, are allowed a lower rate of about 4.5 percent, matching the contributions of employees. These funds are among those that are not subject to the 1 percent tax levied on special corporate pension funds. As of March 1989 more than 7 million workers reportedly participated in 1,259 such MHW-approved trusts.

Other Pension Plans - Company pension plans, known generically as kigyo nenkin, may or may not have tax advantages. Of the type that does, tax-qualified pension plans (tekikaku nenkin) are popular with medium-sized firms. Out of an estimated 71,000 such plans in 1987 approximately 56,000 were established by companies with fewer than 100 people. The plans' popularity in part stems from their ability to offer a way to gain a tax advantage for the most widely used form of Japanese retirement benefit, the lump-sum payment. For the most part, contributions come solely from the company. (Less than 2 percent of the plans in 1980 reportedly took employee contributions.)

Premiums in the past could be handled only by insurance or trust companies, but recent changes have broadened the range of financial institutions that can invest the money (see below). However, the firms assigned to handle the pension funds pay a 1 percent tax on the money they earn each year. Both Keidanren (Japan Federation of Economic Organizations) and Nikkeiren (Japan Federation of Employers' Associations) have called for the tax to be dropped to encourage more small firms to adopt pension plans. Branches of the Ministry of Finance and the Ministry of Labor jointly oversee tax-qualified pension plans.

These company plans typically pay retirement benefits either in the form of a lump sum, a fixed-term annuity (of about 10 years) or a combination of both. Due to the limited term of annuities, many employees opt for a simple one-time payment to get control of the funds immediately. Special tax breaks for lump-sum payments also make this option attractive.

Another type of company plan has no pension-related tax advantages but can be used for retirement benefits at the firm's discretion. Since a company-provided pension is not universally mandatory (except as noted above), some companies use a retained-profits reserve to fund pensions. Since these payments do not need to follow antidiscrimination and other rules established under tax-qualified plans, some firms prefer this flexibility.

Premium/Benefit Adjustments

Two major changes made by the 1986 reforms involved an adjustment of EPI premiums and a realignment of retirement benefits to past salary. At the end of 1988 the Diet enacted a 3 percent consumption tax also with the intent of preparing for a future when fewer workers would be supporting more retirees, who, in turn, would be paying lower income taxes.

• Premiums - To avoid overburdening future generations of workers, which under the old government pension system faced a projected employer/employee premium rate of 38.8 percent of monthly remuneration in the year 2025, the now-anticipated EPI contribution rate in the year 2025 would be 28.9 percent, of which employers and employees would pay half. If a proposal to delay pension eligibility until age 65 receives approval in the future, the combined premium could drop to 23.9 percent. Even that rate -- nearly double the current tax -- would be stiff. Whether future legislators will endorse the increases will depend on the alternatives, including whether to keep annuity-style benefits at their current level of about 68 percent of a worker's base salary. This figure, which does not include bonuses, averages the career earnings of an employee and adjusts for inflation.

• Benefits - Prior to the 1986 reforms the government pension program was geared to provide the average worker with a dependent wife after 40 years of work with 83 percent of his gross monthly remuneration, a figure that averages standard (nonbonus) wages or salaries over the entire time the beneficiary has paid into the system and adjusts for inflation. That rate, as noted, now stands at about 68 percent, although the decision to provide separate social security-style benefits for dependents (who now can draw a check if they are disabled or divorced) complicates a direct comparison of the rates.

Mr. Murakami, who serves on several government pension advisory panels and is an adviser to Nippon Dantai Life Insurance Co., Ltd., estimates that the monthly pension benefits paid to an average male retiree with 35 years on the job is about Y190,000 ($1,300), or roughly 68 percent of his monthly remuneration (see Table 6) when combined with the basic social security payment. The earnings-related portion from the employees' insurance pension program comes to about 30 percent of a worker's average career earnings, the pension expert said. However, given that the twice-a-year bonuses paid by most big corporations are not figured into the calculation, Mr. Murakami suspects that pension

Table 6: Japanese Companies' Annual Employee Pension Costs, FY 1981-FY 1988

Fiscal Year	Number of Businesses	Insured Employees	Monthly Average Remuneration (in yen)	Lump-Sum Payments (in millions of yen)	Pension Payments (in millions of yen)
1981	985,751	25,584,651	Y198,288	Y1,115.7	Y4,280,813.0
1982	1,000,788	25,906,815	207,253	1,207.3	4,855,942.7
1983	1,010,787	26,230,929	213,041	1,225.9	5,310,923.8
1984	1,020,560	26,619,915	220,350	1,150.4	5,898,344.0
1985	1,029,992	26,942,296	231,566	1,194.1	6,652,034.2
1986	1,049,799	26,720,238	237,166	1,451.1	7,906,084.6
1987	1,104,675	27,437,017	241,391	999.6	8,582,981.8
1988	1,207,141	28,445,483	248,712	997.2	8,940,507.8

Note: The yen figures can be converted to dollars at the following average fiscal year exchange rates: FY 1981, Y227.52; FY 1982, Y249.64; FY 1983, Y236.33; FY 1984, Y244.19; FY 1985, Y221.09; FY 1986, Y159.84; FY 1987, Y138.35; and FY 1988, Y128.26.

Source: Social Insurance Agency

checks come to roughly 50 percent of yearly salary.[3] Yet, since these calculations are based on gross income, Mr. Murakami contends that pensions (including social security) actually replace almost 80 percent of net income, after deducting for differences in income taxes and health costs, among others.[4] (In 1985 social security was expected to replace 63 percent of the income received by an American earning minimum wage.)

These figures do not include the lump-sum retirement payment popular in Japan, which forms about 90 percent of the benefits paid out of tax-qualified pension funds, according to Mr. Murakami.[5] Lump-sum payments often go for a variety of purposes other than income maintenance, such as paying for children's advanced education or weddings (a considerable expense if traditional form is followed). Of course, if the educated or married child supports the parent in retirement, this, too, could count as income. Paying off the home mortgage is another popular use of the lump-sum payment. All three uses mirror the relatively early retirement encouraged by companies in Japan since these are costs associated with maturity and not necessarily old age. Future attempts to adjust the pension system will look at the retirement age along with a variety of other alternatives.

Looking Ahead to Further Change

Governments trying to balance the income needs of senior citizens with a shrinking labor pool typically look at hiking the retirement age, which achieves a double goal of alleviating an employment crunch (at least nominally, if that problem exists) and increasing the years of contributions to the funding vehicle. Another option is reducing social security benefits (and/or, in Japan, EPI pension payments), which challenges assumptions about how much support the government is expected to give senior citizens to ward off poverty even at the cost of other programs. This option brings into play, too, how much workers should be saving for retirement, either on their own or through company pension programs. Additionally, policymakers are questioning how much of the elderly's income needs they can shift to private enterprise. Raising premiums is another way governments can assure a flow of funding for income security.

Tinkering with Retirement Ages - The government's push has been all uphill to raise the retirement age from the traditional 55 to age 60, which is the age at which the majority can receive pensions under the EPI scheme, either through the government or the private-operated version. According to a July 1989 Ministry of Labor survey, 86.4 percent of Japan's large companies have adopted this retirement age, while 61.2 percent of the firms that employ fewer than 100 workers have done so. Thus, the total number of firms with an official age of 60 for retirement climbed 3.1 percentage points from the previous year, the ministry said. Further efforts to set age 65 as the new gold-watch milepost continue to run into problems (see JEI Report No. 11B, March 16, 1990).

[3]Kiyoshi Murakami, "When I'm Sixty Five?" Look Japan, February 1990, p. 8.

[4]Kiyoshi Murakami, "Aging and Pensions in Japan." Paper presented at the "Aging in Japan: Lessons for the U.S.?" forum sponsored by the Employee Benefit Research Institute and the Population Reference Bureau, Washington, D.C., July 26, 1989.

[5]Ibid.

Some observers contend that the ruling party's loss of its upper house majority in the July 1989 elections means that reform of the retirement age will be delayed as much as six years (at which time the other half of the seat-holders in the upper house will have stood for election). Of course, if the Liberal Democratic Party regains control earlier (see JEI Report No. 20B, May 18, 1990), the retirement question could get quicker action. Labor groups, however, usually staunch allies of the opposition parties, tend to support the advanced retirement age (in contrast to their opposition to a higher age for benefit eligibility), while the LDP's business allies oppose legislated retirement ages.

Ironically, while the government pushes for the higher retirement age, some large companies are considering pushing their employees toward the door even earlier to open up more top management slots.[6] (A similar dichotomy appears in the United States. Many American firms are using early retirement offers to retrench and consolidate operations, while reforms to the Social Security Act postpone the availability of full benefits to age 67 -- instead of the current 65 -- for those who turn 62 after the year 2022.)

Increasing the retirement age ostensibly could help offset a labor shortfall in Japan, a gap projected by the International Labor Organization at 2.7 million workers 10 years from now. However, older, experienced workers may not fit the bill; the typical call is for young, mentally and physically agile male workers for whom the job-to-applicant ratio in late 1989 was 2.11 versus 0.24 for those over age 55. And, whether voluntarily or not, Japan's 65-and-older male workers are decreasing in number. In the 1960s over half continued to work but in 1985 only 37 percent did. Among women the decline was less, but it started from a lower base of 25.6 percent working after age 65 in the 1960s and dropped to 15.5 percent continuing to work in 1985.

The company-oriented attitude of Japanese "salarymen," which make up only about one-third of the working population, means that job security and seniority-based wage increases have their limits if the firm is to remain competitive. Thus, to avoid being locked into higher salaries for older workers, companies have taken to holding the line on increases, according to one research institute. Roumu Gyousei Kenkyusho (Labor Administration Research Institute) estimated that 20 years ago a 55-year-old employee who had been working for a company for 33 years received about 4.68 times what a new employee did. That rate now is 3.56, the institute reported.[7] At a 1989 forum on the problems of aging in Japan David Crawford of Wyatt Co., an employee and actuarial consulting firm, noted, "In fact, companies are dealing with the age shock in their work forces by restructuring their pay systems away from the seniority principle and towards some basis related to performance. It is most often a gradual process but the direction is clear: older workers will not enjoy higher pay simply because they are older." He cited Nippon Steel Corp. as an example of a company that had revised merit-to-seniority-pay ratios from 50-50 to 60-40 in

6"Big Companies: Retirement at 50," Business Tokyo, February 1990, p. 7.

7"Labor Letter: Competence Ousts Seniority," Wall Street Journal, March 14, 1989, p. 1.

1988 with no pay raises tied to seniority for managers above the middle-management level.[8]

Managers who want to keep working may even be encouraged to leave early if their corporation makes arrangements for them to transfer to good jobs in affiliated companies. Others who want to keep working might be rehired at less pay for the same amount of work. MOL's 1989 white paper noted that about 80 percent of the 2.76 million retirees in the 60-64 age bracket continued to work for a few more years under special programs.

The Labor Ministry's FY 1990 budget includes an increase for its program to give companies monthly incentives to hire workers over the age of 60. Under the plan a company with more than 6 percent of its work force in the 60-65 age span can receive Y30,000 to Y40,000 ($200 to $267) for each worker, depending on the size of the company. MOL also provides assistance to retirees looking for new jobs.

A review of the government's policies toward retirement and the leisure/work opportunities for those over 65 is the task of an advisory committee appointed in late 1989 by Prime Minister Toshiki Kaifu. Similar to one set up by his mentor, the late Prime Minister Takeo Miki, the Committee on Japanese Society in the 21st Century is to look at the long-term funding possibilities for senior citizens' income. A report released in April by the Provisional Council for the Promotion of Administrative Reform (see JEI Report No. 17B, April 27, 1990) called for further reforms of the social security system, such as expanded medical and basic income benefits, as well as actions to address the discrepancy in a system where a flat-rate benefit is provided all elderly but only some workers get pensions. The panel urged equitable sharing of retirement financing among generations and recommended that an individual's combined national (including social security) and local taxes be no higher than 40 percent of gross income by 2000 and 50 percent by 2020.

Lowering Benefits - A major concern in establishing generational equity is whether decreased support for the elderly would thrust them into poverty and, conversely, whether increased help would pose problems to the young. Since those over age 70 pay relatively little for medical care under Japan's system of health insurance (see JEI Report No. 16A, April 21, 1989), they currently avoid one of the highest costs facing older people. The country, however, pays. In 1980, for example, the 9 percent of the population aged 65 and older accounted for 27.4 percent of the government's medical expenditures. (For more information about the economic costs of social welfare in Japan, see JEI Report No. 12A, March 27, 1987.)

Observers of Japan's booming economy wonder whether those growing up now in relative affluence will demand more benefits and seek more leisure activities in their retirement years than do those who remember the struggles of the postwar years. People with land in populated areas certainly have benefited

[8]David Crawford, "The Impact of Aging and Cultural Changes on Pensions in Japan and Its Relationship to the U.S." Paper presented at the "Aging in Japan: Lessons for the U.S.?" forum sponsored by the Employee Benefit Research Institute and the Population Reference Bureau, Washington, D.C., July 26, 1989.

from the surge in land prices. But not all Japanese own their homes, and the number who do dropped from 62.4 percent in 1983 to 61.1 percent in 1988 (see JEI Report No. 30A, August 4, 1989). The young are particularly hard hit by the rising cost of housing, as indicated by the fact that only 17.8 percent of those aged 25 to 29 owned homes in 1988 compared with 27.9 percent of people now aged 50 to 54 who owned their homes by the time they reached age 29.

Home ownership rates and other statistics indicate that the majority of Japanese who already have retired may not face dire poverty if benefits were to be adjusted. However, changes in Japan's social fabric threaten new wrinkles, including the declining number of elderly who live with their children and the increased number of mature women in the work force. In 1970 approximately 70 percent of the population over age 65 lived with their children. A 1988 Ministry of Health and Welfare survey showed that percentage down to 61.9 percent, although it was noted that almost one-fourth of Japanese families live with a person aged 65 or older. The larger number of working women means fewer are at home to care for the aged, which potentially could increase the numbers of elderly living in retirement settings. Of course, if grandma and grandpa own the home and their children rent elsewhere, the younger generation may be willing to make accommodations in living arrangements.

Other MHW figures show that people over age 65 were relying more heavily on social security payments and retirement benefits than savings or other earnings in the mid-1980s than was true for their counterparts between 1975 and 1981. By 1984, for example, social security and retirement benefits counted for 56.9 percent of the elderly household's gross income compared to 34.3 percent in 1975, when savings and salaries/wages made up 56 percent of the total (versus 34.5 percent in 1984). Policymakers have to address the question of whether cutting back on benefits would be fair to workers who have begun to expect them. A survey done by the Prime Minister's Office and released in March 1990 indicated that of the 3,800 or so men and women aged 30 and over who responded, more than half (61.4 percent) are pessimistic about the solidity of Japan's welfare system, which includes basic social security benefits, pensions and health care. Nevertheless, 62.8 percent said they want the safety net for senior citizens increased. A full 70 percent want to continue working in their old age.

A 1989 study for the OECD suggests that the social security and pension rates paid by current workers and their employers could drop as much as 5 percentage points if Japan calculated benefits on the basis of net rather than gross wages with a gradual increase in the retirement age.[9] Mr. Murakami has noted that the switch to a net income-based benefit level would counter a potential situation in the year 2020 in which "active employees (typically [a] four-member family) and retired persons (usually husband and wife) will receive the same amount" of adjusted take-home pay if the combined employer/employee contribution rate jumps to 30 percent.[10]

[9]Alan J. Auerbach, Laurence J. Kotlikoff, Robert P. Hagemann and Giuseppe Nicoletti, "The Economic Dynamics of an Ageing Population: The Case of Four OECD Countries." OECD Economic Studies No. 12, Spring 1989, pp. 76-77.

[10]Murakami, "Aging and Pensions in Japan," op. cit.

The Role of Savings

The relative youth of Japan's old-age insurance system (which did not cover a variety of workers until passage of the 1959 National Pension Act) often is used to explain Japan's high savings rate. In fact, even the Economic Planning Agency contends that the growth of the social security system and the spread of pension programs are responsible for trimming the household savings rate (see Table 7). The agency estimates that the increased number of elderly will eat into the household savings rate even more, helping push it toward about 11 percent of disposable income in the year 2000. This would be good news to Americans who complain that Japan's high savings rate is one of the barriers to increased consumption (and, thus, imports).

Table 7: Japan's Household Savings Rate, 1967-88

(percent of disposable income)

Year	Savings Rate	Year	Savings Rate
1967	13.5%	1978	20.8%
1968	15.8	1979	18.2
1969	15.6	1980	17.9
1970	17.9	1981	18.3
1971	17.8	1982	16.5
1972	18.2	1983	16.3
1973	20.4	1984	16.0
1974	23.2	1985	16.0
1975	22.8	1986	16.4
1976	23.2	1987	15.1
1977	21.8	1988	14.8

Source: Economic Planning Agency

However, an annual government survey indicated that the amount of new savings in 1988 achieved by those over age 65 was only 11 percent less than the average of all households (about Y240,000 or $1,597). And a 1988 survey by the Ministry of Posts and Telecommunications revealed that 70 year olds had the largest piggy bank, which, including investments in insurance and negotiable securities, averaged nearly Y14.8 million ($98,500). MPT calculated that the elderly need close to Y23.9 million ($159,000) in savings on average to feel financially secure with annual living expenses estimated at Y3 million ($19,867). Survey responses showed a Y14 million ($93,300) shortfall for the average family, although MPT, which runs the postal savings system, has obvious reasons to promote savings.

Whether savings actually drop in countries that assure basic incomes for senior citizens, and whether that assurance is the reason, remain open to debate. In the aggregate, however, social security and pension trust funds reflect savings for a country as a whole. Obviously, Tokyo is hoping to create a large pool capable of handling its wave of baby boomers.

Using Tax Policy to Shore Up Support

A 3 percent consumption tax went into effect in April 1989 along with associated changes in the personal income tax structure to help avert a funding crisis as a larger population of elderly draws more income support from the government. Had Tokyo continued to rely on personal income taxes as a main source of general account revenues, the average retiree would have paid very little into the state coffers. For example, a lump-sum "termination" payment is tax-free up to Y15 million ($100,000) for a 30-year employee and up to Y22 million ($146,700) for a 40-year employee.

The personal income tax reforms meant that the number of brackets for the national tax dropped from 15 in FY 1986 to five and that the top rate was 50 percent rather than 70 percent. Also, the elderly were allowed to retain tax exemptions on certain types of savings accounts, while most others lost that benefit. Thus, the tax bill of an increasing percentage of the population would have decreased while the government's need for revenue grew to pay for the gap between social security and pension contributions and payments.

The consumption tax, while regressive, was designed to raise more money than the commodity and other taxes it replaced. Retirees, who would be expected to cut back on consumption as they left the work force, would pay only on the same basis as other age groups. And, while the ranks of senior citizens swelled and theoretically shrunk income tax payments from this segment of the population, older people still would face the same consumption tax, thus sustaining a source of funds for government social security and pension obligations.

Other tax incentives encourage company funding of private pension plans. As mentioned earlier, Keidanren and Nikkeiren have suggested that the abolition of the 1 percent tax on income from company-funded pension plans would result in more small companies offering coverage. While Tokyo looks at such suggestions, policymakers also are considering how to make the money already in the government's trust funds work better for them since the interest earned on social security and pension contributions can offset the amounts needed for future payments.

The Perils of Pension Fund Management

A piggybank valued at Y62.6 trillion ($417.2 billion) is not taken lightly -- and that is how much money had been collected in social security taxes and payments to the government's employees' pension insurance plan as of March 31, 1988. But when the interest on this money amounts to 5.1 percent, some pension experts begin to question whether more flexibility should be allowed in managing the trust funds. Evidence of the debate over how to invest the money was veiled in a mid-June 1989 article in Nihon Keizai Shimbun, which noted that the Ministry of Health and Welfare had achieved 1.5 percentage points more interest on its management of a Y4.1 trillion ($27.5 billion) public pension fund in FY 1988, for a total of Y60.6 billion ($404 million), than had the Ministry of Finance on a pension fund managed by its Trust Fund Bureau. MHW has suggested it would like to see as much as one-third of social security and EPI payments privately managed in hopes of gaining returns of at least 9.1 percent a year.[11]

[11]"Taking the Lid Off Japan's Pensions Pot," The Economist, February 4, 1989, p. 73.

A first step in opening the large corporate-sponsored pension business to competition came last December when the Diet removed the limits that had allowed only insurance companies and trusts to manage these funds, estimated at the time at Y19.6 trillion ($130.7 billion). Jumping to the challenge were 133 investment advisory firms, including 36 foreign companies. Some experts worry, however, that traditional insurance and trust firms will retain most of the business because of the absence of a system to rate the performance of the new pension fund managers. What may worry people approaching retirement, however, is whether their funds will be safe. Japan lacks a mechanism to ensure fiduciary responsibility.[12]

Outlook

Japan's reforms of its social security system and the government-run pension program and its encouragement of corporations to institute their own pension plans have set the stage for a comfortable retirement for the first wave of baby boomers, heading for 65 by the year 2011. But the increasing demands on the working population as more and more senior citizens drain money from the system mean that additional changes are necessary. Among those likely are a uniform age of 65 (and possibly older) for retirement and the same standardized age for eligibility to receive payments from the government-operated pension plan. Also possible are revisions that base benefits on net rather than gross remuneration and that continue increases in the contribution rate for working persons, including an earnings-indexed contribution for basic social security benefits. While private pension fund managers hope that Japan's economy continues to generate steamy investment profits, Tokyo will be eyeing how much leeway to give for investing public trust funds.

All these policies will have to mesh with plans to continue relying on domestic demand to move the economy forward. This, in turn, requires savings and investment from households and companies, respectively. If either feels constrained by retirement policies -- for example, if companies lose their flexibility in reassigning management or are required to retain workers that no longer are aggressive in formulating or adapting to new technologies -- the economy could lose two of its traditional generators. Tokyo's time is running short, however, to move toward policies that help keep pensioners, companies and the public trust funds solvent.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published June 1, 1990 because of the Memorial Day holiday. The next issue will be dated June 8, 1990.

[12]Saburo Kobayashi, "Employee-Sponsored Pension Systems in the United States and Japan," US-JP Occasional Paper 87-03, Harvard University Program on U.S.-Japan Relations, p. 18.